

In the Eye of the Storm

An interview with State Treasurer Frank Caprio

Seeing myself as a bright thinker (a view not always confirmed by friends and family, I concede), I decided that given the current economic maelstrom buffeting our country, who better to chat with than the state's financial point man, State Treasurer Frank Caprio. Maybe he'd even offer me a free tip or two to help my own beleaguered portfolio.

During our first meeting, I couldn't help but notice how calm he and everyone in the office was. I didn't see anyone jumping out windows or panicking in any way. Maybe it was the soothing voice of Erin Burnett on CNBC playing on the TV screens in the background, as the market dived another few hundred points. When we figured out the state's investment fund lost approximately \$150 million during the 45 minutes of my first interview, and I asked if maybe he should be doing something other than talking to me, Caprio calmly said not to worry: "We're in it for the long haul."

During our second interview, he predicted the market would start heading back up soon, regaining 10-20% over the next year. And doggonit, after watching market losses fluctuate by a few hundred points again while we talked, when I got back to the office, the market was in positive territory – for a few seconds, anyway.

When he decided to run for the Treasurer's office two years ago, it seemed like a safe first step for the politically upwardly mobile, financially astute Caprio. That is, until all hell broke loose. Even before the current meltdown, Caprio had initiated a number of sensible actions designed to strengthen management of state finances under his control, including making his own office more productive and efficient. Among them:

- * Pulling out \$1 billion in subprime mortgage investments before they became an issue and improving the volatility of the overall portfolio

- * Hiring three consultants through the RFP process to manage various aspects of the state's \$8 billion pension portfolio and using the RFP process to hire consultants rather than the traditional extension of contracts

- * Working with the Rhode Island Student Loan Authority to lead a negotiation that enabled RISLA to become the first student lending agency to sell bonds since September of 2007, following the market being shut for six months

- * Transferring of \$323,000 surplus from refunding Bond Authority to help close the budget gap thanks to streamlining operations

- * Developing a financial SWAT team consisting of the Treasurer, legislative leaders and Governor to handle urgent financial issues

- * Renegotiating bank fees, saving the state \$283,000 annually

Caprio is committed to running his office on a tighter budget. Already he has turned in his state vehicle and

pays for his own travel. Proudly he points out his is the only department that has lived within its budget for the past two years and reiterated his commitment to fight for full spending disclosure of all state government agencies, starting with his own in a few weeks. "Our goal is to lead by example," promises Caprio.

But his biggest challenge, no doubt, is dealing with the impact on state finances under his control from the national economic and financial crisis.

Most challenging is a pension fund that, while losing value before Caprio took office, has decreased in value from approximately \$7.2B when he took office to \$6.3B as of Nov. 1, a loss of 12.5%. "Our results are consistent with the many states and large institutional investors who allocate approximately 60% of their portfolio to equities," Caprio said. Noting his "long haul" comments and estimates for recovery, Caprio said there is no need to panic and make drastic changes in portfolio makeup. "We have done a national competitive search and hired new consultants to assist the State Investment Commis-

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sion in its asset allocation, implementation and money management selection decisions."

Why is all this important to you and me? A lower pension fund value means a required increase in state contributions to the retirement fund (employee contributions are fixed by state law). Caprio said the use of a five-year average minimizes the impact from value decreases over short periods of time. While offering no specifics, Caprio said that further pension reform is needed because the current system is "unsustainable."

Caprio's office, in conjunction with the SWAT team, had to chase down \$62 million in state assets currently held in a U.S. Government Money Market Fund frozen by the U.S. Securities and Exchange Commission (SEC) in late September. The issue here was not money lost, but money delayed by the SEC to handle problems in another fund. "We are receiving \$20M within the next two weeks. As the rest of the government guaranteed holdings in The Reserve's Government Fund mature, additional payouts will be made," Caprio said.

State financial issues and reduced revenues have unfortunately increased the state's short-term cash needs. Caprio said the state was not delaying any payments and, despite skeptics like the Governor, offered

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average Rhode Islanders the opportunity to purchase tax anticipation bonds from the \$350 million bond issue. "Rhode Island citizens purchased \$25 million in the recent sale when pre-sale estimates showed that only \$2M would be sold to retail. It was a huge success and because of the strong demand, the interest rate was a low 2.20%, which saved the state over \$3M in expected interest cost. I was very satisfied with the sale. California had to pay 4% interest on bonds they issued just two weeks prior to our own sale. Because the credit markets have been very volatile, I think it's appropriate that we offered Rhode Islanders the chance to purchase if it was a suitable investment for them."

Caprio said that unlike other states running to the feds for bailout help, Rhode Island is better prepared to handle short term cash flow issues because of its regular reliance on tax anticipation notes and says he doesn't foresee looking to the feds for money like New York and California. As for the state's recent bond downgrade from AA to AA-, Caprio's office said it probably had to do with a number of things tied to weak revenues, but that the small decrease shouldn't have much increase on borrowing.

On another front, Caprio volunteered a somewhat controversial opinion that the State consider purchasing financially troubled Twin River as a last resort, "The state lottery has run a very successful Video Lottery Terminal operation at Twin River over the years, currently netting profits of \$250 million per year. The State Lottery pays the owner of the Twin River real estate approximately \$50 million per year. Twin River's loan on the real estate and business is close to default. Due to the fact the state currently runs the 5,000 VLT's, it makes sense to control the real estate as well if the current owners can't work out their debt issues with their banks. The response from interested parties has been positive."

With the wild fluctuations in stock prices and their currently decreasing valuations, I asked Caprio about investing in cold, hard cash instead. "When measured against inflation, the actual value of the pension fund would decrease if it were to just be in CDs and money market funds. The State Pension Fund has averaged over 8% annually over the last 20 years. By being exposed to equity and debt markets and following the similar asset allocation models of most state and large corporation pension funds, we should realize a better return in the long-run."

Caprio had no comments about a run for Governor, other than to remind me he has outlasted other potential opponents. While he was considered a front runner by most insiders I spoke with on the Democratic side, it will be interesting to see what impact the current economic and financial factors, and his "lead by example" performance in dealing with them has on his chances.

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